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ABSTRACT

Part of a series of classroom aids designed for real estate instructors, this instructional packet was developed to help real estate students understand the rules, regulations, and laws governing home foreclosures under deeds of trust in Texas. Information on home foreclosures is presented, covering: (1) the three elements of a proper foreclosure; (2) reasons lenders foreclose; (2) the steps taken by the lender and the trustee before the foreclosure sale; (3) regulations governing foreclosure sales; (4) terms of the sale; (5) deficiency judgements in the event that the foreclosure sale does not generate sufficient revenue to cover the expenses of the sale and the full amount of unpaid principal, interest, attorney's fees, and other charges; (6) invalid sales; (7) recovering damages from a wrongful foreclosure; and (8) procedural points the homeowner should consider in evaluating the foreclosure. The packet also includes a series of 15 overhead transparency masters keyed to the text. (EJV)

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TEACHERS INSTRUCTIONAL PACKET (TIP)
No. 15, Spring 1987

TEXAS HOME FORECLOSURES

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TIPS on the TIP

This Teacher Instructional Packet (TIP) is designed to provide the real estate instructor with a classroom supplement. Packets have been reviewed carefully, but there is always room for improvement. Suggestions to improve the usefulness of the TIP are welcomed.

Introduction to the TIP-15

TIP-15 has been developed to help students understand requirements for home foreclosures in Texas. This material is based on Texas Home Foreclosures, publication 529, June 1986. This material is provided as a **supplement** to existing course content. It is not a pat presentation. Instructors may use as much or as little as needed.

TEXAS HOME FORECLOSURES

As most of the United States welcomes lower petroleum prices, oil-producing states such as Texas are experiencing adverse economic effects. Texas homeowners, especially those whose jobs are tied to the petroleum industry, may be in danger of losing not only their jobs but also their homes.

Foreclosure is a frightening thought. Homeowners facing foreclosure, for the most part, are unaware of their rights and are unable to protect their interests from an improper or irregular foreclosure process.

VISUAL #1

Overview

A knowledge of the rules, regulations and laws governing Texas home foreclosures is especially timely. Understanding the prerequisites for, as well as the requirements of, a valid foreclosure sale helps guide those facing home foreclosure. This report is limited to foreclosures under deeds of trust. It does not cover foreclosures under executory contracts which are sometimes referred to as contracts for deed.

PROPER FORECLOSURE

A proper foreclosure has three elements: (1) the real estate lien note as signed by the mortgagor (buyer) at closing for the balance of the purchase price, (2) the deed of trust as signed by the buyer at closing giving the mortgagee (lender) a security interest in the land being purchased and (3) the pertinent Texas statutory and case law. As a general rule, a foreclosure is proper as long as it complies with the procedure outlined in the deed of trust. Texas law is relevant only where the deed of trust is silent on an issue or where the deed of trust conflicts with Texas law.

VISUAL #2

Three Elements Governing Forclosure

There is no mandatory deed-of-trust form required by Texas law. The forms may vary from lender to lender. For purposes of this report, however, the deed of trust prepared by the Legal Forms Committee of the State Bar of Texas will serve as the basic guideline. Other deeds of trust may contain different provisions.

Persons who do not have a copy of their deed of trust may secure one from the county clerk's office in the county where the land is located. The lender records the deed of trust to secure an interest in the property being purchased.

WHY LENDERS FORECLOSE

To trigger a foreclosure, the borrower must, among other things, default on a periodic payment required by the real estate lien note, the terms of which are described in the deed of trust. Upon such an occurrence, the lender has the option of accelerating collection of the entire unpaid balance of the note. In other words, the entire amount of remaining indebtedness, not just the periodic payment in arrears, becomes due and payable.

This provision is known as the acceleration clause. Without it, the lender would be forced into a series of foreclosures, foreclosing only on the amount of the installment in default and not the entire unpaid balance of the note.

If the lender chooses to accelerate, three-notices must be given to the debtor unless such notices are waived in the deed of trust:

VISUAL #3

Notices Triggering Acceleration Clause

(1) a demand notice for the installment in arrears and thereafter affording the debtor an opportunity to remedy the default,

(2) a clear and unequivocal notice of the lender's intent to accelerate the debt after the debtor has been given a reasonable time to cure the installment in arrears and

(3) a final notice that acceleration has in fact occurred.

The first notice regarding the demand for the payment in arrears generally is not required by the deed of trust. However, the Texas Supreme Court has suggested that the lender "bring home to the borrower that failure to cure will result in acceleration of the note and foreclosure under the power of sale." It has been held proper to combine the first notice concerning the default with the second one involving the intent to accelerate.

It is possible for the debtor to waive the described notices in the deed of trust. The Texas courts disagree somewhat as to the proper language for an effective waiver. Some courts have held that certain language waives the notice of acceleration but not the notice of intent to accelerate. The majority of courts, however, have upheld the effectiveness of most waivers. In cases of doubt, the courts tend to prevent acceleration of the note without proper notices.

Interestingly, the lender's conduct may forfeit the right to accelerate without notice even where an effective waiver has been included in the deed of trust. The case in question involved a lender who had accepted seven consecutive late payments and then attempted to foreclose without giving notice after the eighth default occurred. The courts held the lender's past conduct destroyed the clear and unequivocal intent to accelerate once the debtor defaulted on a payment.

If the debt is accelerated following a default, the mortgagee may proceed to foreclose on the property by a non-judicial sale. No lawsuit is required. If the foreclosure sale is conducted in accordance with the deed of trust and Texas law, the sale is effective in transferring title to the highest bidder.

STEPS BEFORE ACTUAL SALE

VISUAL #4

Steps Before Sale

The steps leading up to the actual sale are described in the deed of trust and in Section 51.002 of the Texas Property Code. They are:

1. The lender requests the person designated as the trustee in the deed of trust (or the substitute trustee, as the case may be) to sell the property.

2. The trustee must give a 21-day advance notice of the sale by posting, sending and filing various notifications in the following manner:

   A.) A written or printed notice must be posted at the courthouse door of the county or counties where the property is located. If the property is located in more than one county, posting must occur in all counties where the land is located and specify the county in which the sale will occur. The day of posting counts as the first day of the required 21. It has been held that the phrase "at the courthouse door" means near any main access door to the courthouse.

   B.) The same written or printed notice posted at the courthouse door also must be filed with the county clerk of each county in which the property is located. (This

filing is required for all foreclosures occurring after January 1, 1984.)

C.) The written or printed notice likewise must be sent by certified mail, postage prepaid, to each debtor obligated on the indebtedness. The notices must be addressed to the debtor's most recent address as shown by the lender's records. (The day the notice is postmarked counts as the first day of the required 21.)

Note: There is no Texas statutory law regarding the contents of the notice. Because the purpose of the notice is to alert the borrower and prospective purchasers of the sale, the notice should contain: the date of the deed of trust along with the volume and page where it is recorded; the name of mortgagor, mortgagee and trustee; a statement of default and a request for the trustee to sell property; and the time, date, terms and place of sale.

FORECLOSURE SALES

VISUAL #5

Sale Procedure

The sale, according to Section 51.002(a) of the Texas Property Code, may be conducted on the first Tuesday of any month between 10 am and 4 pm following the 21st day after proper notices have been posted, filed and sent. Most deeds of trust specify the sale is to occur at the courthouse door. Otherwise Texas law merely requires a public auction sale held in the county. However, the uniform practice is to conduct the sale on the courthouse steps. If the Tuesday should occur on a legal holiday, the sale is still valid. The exact hour of the sale need not be specified in the notices.

These notices are the minimum requirements necessary for a valid foreclosure sale. However, should the deed of trust require more, the

additional requirements must be strictly followed. For example, many pre-1976 deeds of trust required posting at three public places, not just at the courthouse door.

As to the personal notices sent the debtors of the obligation, only the debtors and guarantors must be notified at their last known addresses. Junior lienholders on the property are not required to receive notice unless a contractural agreement mandates it. As a matter of policy, however, all lienholders and other interested partners should be contacted to insure spirited bidding.

VISUAL #6

The Trustee

The trustee is the central character in the foreclosure process. The trustee has the sole authority to sell the land and to convey title. The power to sell, unless authorized by the deed of trust, cannot be delegated to another.

In the deed of trust, the debtor grants the power of sale to the trustee. The debtor may select the trustee, but in practice, it is the lender who designates the person to serve.

Practically anyone may qualify. The trustee may be the mortgagee or the mortgagee's agent or employee. The trustee may have other direct or indirect interest in the lien or in the property.

It is not the trustee's relationship to the debtor or lender that is critical. Instead, it is how the trustee exercises his or her legal duties toward them. By law, the trustee owes a fiduciary duty to both. The trustee must act in good faith and fairness to both parties in conducting a fair, impartial foreclosure sale after posting, filing and sending proper advance notices.

If the designated trustee is unavailable, a substitute trustee may be appointed in strict compliance with the deed of trust, otherwise the resulting sale is invalid. Only the party or parties designated in the deed of trust may appoint the substitute trustee. This is generally the lender or any subsequent holder of the indebtedness.

The conditions contained in the deed of trust for the appointment of a substitute trustee, if any, must be strictly adhered to. For instance, if the deed of trust provides that a substitute trustee can be appointed only where the original trustee fails to act, or where the original trustee resigns or dies, then these conditions must occur before a valid substitute trustee may be appointed.

The wording used in the State Bar Deed of Trust contains no conditions or contingencies for the appointment of a substitute trustee. It simply states that the lender may appoint a substitute trustee without any formality other than the designation in writing of a substitute trustee.

There is no requirement that the resignation of one trustee and the appointment of another be in writing or recorded unless the deed of trust so provides. If the original trustee posts, files and sends the required notices, the new duly appointed trustee need not wait 21 days after his or her appointment to conduct the sale. The sale can still occur 21 days after the notices were first posted, filed and sent.

The trustee is the only person who can conduct a valid sale. However, agents of the trustee may sign, post, file and send the notices. Once the notice is posted, the trustee or the agents need not check the courthouse to insure the notice remains in place.

After the necessary notices have been posted, filed and sent and the required 21-day waiting period has elapsed, the trustee may proceed with the sale on the first Tuesday of the following month anytime between 10 am and 4 pm. The trustee commences the sale on the courthouse steps by first reading a copy of the posted notice, second by stating the terms of the sale and then by opening the bidding.

TERMS OF THE SALE

Generally the trustee will require cash only sales. Section 51.002 of the Texas Property Code contains no restrictions as to the type of consideration required. If the deed of trust dictates cash only, only cash bids may be received.

VISUAL #7

Conducting Sale

At the sale, all parties present may bid. Third parties, the lender and even the debtor are qualified.

The trustee may bid, but it is important to ascertain for whom the bids are entered. If the trustee also is the mortgagee, all bids must be for the mortgagee. If the trustee is not the mortgagee, the trustee cannot bid the property either in his or her behalf or on the account of a corporation the trustee controls. However, the trustee may purchase the property in the name of a disinterested third party.

If the mortgagee enters the highest bid, the mortgagee can acquire the property without any out-of-pocket costs as long as the bid price does not exceed the balance of the debt. The lender simply applies the purchase price as a credit against the mortgagor's debt.

As mentioned earlier, the mortgagor (borrower) may bid at the foreclosure sale. But it is unlikely. If the borrower had sufficient funds, he or she would have paid off the installment in arrears to prevent the lender from ever accelerating the note. After the note

VISUAL #8

Rights of Mortgagor

is accelerated, the borrower can still prevent the foreclosure sale by redeeming the entire unpaid balance of the note anytime before the actual sale begins. This is known as an equity of redemption.

There is no right of redemption in Texas. In addition to the equity of redemption, many states give the mortgagor a right of redemption for a certain period of time after the sale occurs. The right of redemption enables the foreclosed borrower to repurchase the property for the price it brought at the foreclosure sale. The right of redemption attempts to insure that the property will generate adequate revenue at the foreclosure sale.

Once the sale occurs, the proceeds are divided in the following manner and in the following order:

VISUAL #9

Division of Sale Proceeds

(1) The expenses of advertising the sale and making the conveyance, including any commission to the trustee and attorney's fees other than those provided in the real estate lien note (the State Bar Deed of Trust includes a 5 percent commission for the trustee;)

(2) the full amount of the unpaid principal, interest, attorney's fees and other charges due and unpaid as provided in the real estate lien note; and

(3) the remaining balance to the mortgagor.

DEFICIENCY JUDGMENTS

Should the foreclosure sale not generate sufficient revenue to cover the first two categories, **the borrower is still personally liable for the balance.** To recover the deficiencies, the lender may institute and obtain a judgment against the borrower. This is sometimes

called a deficiency suit or deficiency judgment.

Many debtors faced with the possibility of foreclosure attempt to convey the property back to the lender. If the lender accepts the deed in lieu of foreclosure, it saves time, the expense of conducting the sale and possible litigation costs associated with an irregular or improper foreclosure. Although the law is not conclusive on the issue, a deed in lieu of foreclosure will satisfy the entire debt held by the lender against the property. Deficiency suits will be eliminated.

If the original buyer resells the property before the existing note is retired, the new buyer may or may not be liable for a deficiency judgment. If the new buyer does not get independent financing, he or she must either "assume" or "take subject to" the existing note. If the note is assumed, the new buyer, as well as the seller, are mutually liable for the monthly installment payments. Likewise, both are jointly responsible for any deficiency judgments. However, if the new buyer takes "subject to" the note, he or she avoids personal liability both for the payment of the existing note and for any deficiency judgments. This leaves the original buyer solely responsible for both.

VISUAL #10

Deficiency Judgments

INVALID SALES

The borrower may complain that the reason the property did not bring sufficient revenue was because of an impropriety in the foreclosure process. If an impropriety can be proven by the preponderance of the evidence, there are two possible remedies available: (1) set aside the sale (rescind it) or (2) sue for damages. The borrower can pursue only one of the two. An election to pursue one bars any action to pursue the other later.

VISUAL #11

Invalid Sale

VISUAL # 12

Remedies for Invalid Sale

An exceedingly low price generated at the foreclosure sale is not sufficient by itself to render a sale invalid under Texas law. However, the greater the disparity between the sales price and its fair market value, the more readily the courts will find any irregularity sufficient for the debtor to successfully challenge the sale. The irregularity, however, must have contributed to the inadequacy of the consideration received at the sale.

Further, the inadequacy of the consideration can be grounds to have the sale set aside under federal bankruptcy laws. If the sales price does not equal or exceed 70 percent of the property's fair market value, the sale can be voided as a fraudulent transfer should the debtor file for bankruptcy within one year of the sale.

If the debtor does attack the sale under Texas law because of an irregularity, the attack will most likely be for damages and not to rescind. To set aside the sale, the debtor must first repay or offer to redeem the property from the purchaser at the price brought at the foreclosure sale. If the debtor possessed such resources, the foreclosure probably would never have occurred.

Also, the statute of limitations may be a barrier. With minor exceptions, an action to set aside a sale must be initiated within four years. And, if the property has been resold during the interim to a purchaser unaware of the irregularities, the action to rescind the sale (but not for damages) is lost.

RECOVERING DAMAGES

For these reasons, most debtors who attack a foreclosure sale seek damages. To recover damages from a wrongful foreclosure, the debtor must prove how much the property would have brought at the sale if the irregularity had not

occurred. In any event, the maximum recovery is limited to the difference in the fair market value of the property and unpaid balance of the note at the time of sale. Where the conduct of the lender or trustee can be proven to have been intentional or malicious, exemplary or punitive damages also may be recovered.

Any action to recover damages must be initiated within four years of the sale. But because only one remedy may be pursued, the borrower must be careful to choose the correct one. The following example is based on an actual case.

A Texas debtor sought damages for the wrongful appointment of a substitute trustee. At the trial, the irregularity was proven but no resulting damages. Consequently, the debtor recovered nothing. However, the court slated that the irregularity was sufficient to have the sale rescinded if such a remedy had been pursued first. Because it was not, the debtor was without further recourse.

Foreclosure will continue to play an important role in the Texas real estate market as the state adjusts to falling oil prices. Even though the homeowner may have defaulted on an installment payment, Texas law requires that a subsequent foreclosure be conducted in strict conformity to the deed of trust and Texas law. The failure to comply may enable the homeowner either to set aside the sale or sue for damages.

EVALUATING THE FORECLOSURE

Here are some of the more strategic procedural points that a homeowner may wish to examine during or after a foreclosure occurs. The list is not all-inclusive and will not serve as a substitute for legal counsel. The appropriate remedies for an irregularity are not included.

VISUAL #13

Procedural Points In Evaluating the Forclosure

1. Did the circumstances prompting the foreclosure actually occur? For instance, was there a default on an installment payment as specified and required by the deed of trust?

2. Did the foreclosure take place within four years of the default? (The Texas statute of limitations is four years. However, unless the note is properly accelerated, the statute of limitations applies only to the delinquent payment due four years ago.)

3. Did the lender notify the debtor of the lender's intent to accelerate the note after the debtor defaulted on the payment? Did the lender notify the debtor that acceleration of the note had actually occurred? If not, was the right to receive such notices waived by the debtor in the deed of trust? (The interpretation of an effective waiver may require the services of an attorney.)

4. If the notices were effectively waived, has the lender received late payments in the past without resorting to foreclosure? If so, the right to foreclosure without giving the required notices at a later date may be deemed improper.

5. Did the trustee (or substitute trustee) or their agents post notice of the intended sale on the courthouse door, file notice of the sale with the county clerk and send notices to the debtors at least 21 days in advance of the actual sale? (The day of posting, filing and sending counts as the first day of the required 21.) If a pre-1976 deed of trust required posting at three public places 21 days in advance of sale, were these requirements met?

VISUAL #14

Procedural Points Continued

6. If the land was located in more than one county, was the notice posted and filed in each county? Did each notice contain information specifying the county in which the sale would be conducted?

7. Were the personal notices sent to each person liable on the note by registered mail to their last known address according to the lender's records? (If the husband and wife have separated, an individual notice may need to be sent to each spouse.)

8. Was the substitute trustee, if any, properly appointed by the rightful parties in accordance with the terms of the deed of trust? Among other things, did the deed of trust require the original trustee to resign? Did the deed of trust require the appointment of the new trustee to be recorded 21 days in advance of the sale?

9. Did the trustee conduct the sale in accordance with the deed of trust and state law? Among other things, was the sale conducted on the first Tuesday of the month between 10 am and 4 pm following the expiration of the 21-day notice period? If cash bids were required in the deed of trust, did the trustee comply? Did the trustee acknowledge and accept all bids at the sale after the notice of the sale was read? Did the trustee leave the sale before it was completed without telling the bidders when it would reconvene? Did the trustee bid and purchase the property in his or her own behalf? Did the trustee conduct the sale on the courthouse steps? (If the foreclosure sale has not occurred yet, the debtor may want to videotape the sale to preserve evidence of any irregularities.)

10. Did the expenses and charges levied against the debtor's interest following the sale constitute usury? Among other things, were the interest charges calculated to the date of sale or were they calculated over the duration of the note as if there had been no default? In other words, were there charges for unearned, unaccrued interest?

11. Was the property in receivorship at the time of the sale? A receiver may have been appointed for an insolvency proceeding or a divorce. If so, the trustee under the deed of trust has no authority to sell the land unless authorized by the court in which the receivorship was pending.

12. Was the debtor alive at the time of the foreclosure? If not, the administrator of the decedent's estate generally has the unconditional right to revoke the sale for up to four years after the debtor's death. (There are several exceptions to this rule).

13. Was the debtor a minor? If so, the property may not be foreclosed except under the probate court's supervision if the deed of trust was executed by the minor's guardian on behalf of the minor.

14. Was the debtor in the armed services or discharged within three months of the proposed sale? If so, without a court order the foreclosure is prohibited by the Federal Soldiers' and Sailors' Civil Relief Act of 1940. See Volume 50 of the United State Code Annotated, Section 532(3). This federal statute applies only if the property was owned by the person before he or she went into the service.

VISUAL #15

Procedural Points Continued

Overview

- Homeowners facing foreclosure need knowledge of Texas rules and regulations

- Limited to foreclosures under deeds of trust

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Visual No. 1

Three Elements Governing Foreclosures

- Real estate lien note
- Deed of trust
- Texas statutory and case law

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Visual No. 2

Notices Triggering Acceleration Clause

- Demand notice for installment in arrears
- Clear, unequivocal notice of lender's intent to accelerate
- Final notice acceleration has occurred

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Texas A&M University
Visual No. 3

Steps Before Sale

- Lender requests trustee sell property

- Trustee imparts three notices 21 days in advance by:
  -- posting sale notice at courthouse
  -- filing notice with county clerk
  -- sending notice by certified mail, postage prepaid, to each obligated debtor

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Texas A&M University
Visual No. 4

Sale Procedure

- Conducted first Tuesday of month, 10 a.m.-4 p.m. following 21st day after proper notices
- Conducted on courthouse steps
- Conducted in compliance with other relevant requirements in deed of trust

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Visual No. 5

The Trustee

- Central character
- Granted power of sale in deed of trust
- May be mortgagee, agent or employee
- Owes fiduciary duty to mortgagee, mortgagor
- Only person who can conduct valid sale

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Visual No. 6

Conducting Sale

- Trustee may require cash only -- must comply with deed of trust
- At sale, all parties present may bid (including trustee but not in own behalf)
- Mortgagee may bid balance of debt without any out-of-pocket costs

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Visual No. 7

Rights Of Mortgagor

- Mortgagor (borrower) may
  -- bid at foreclosure sale
  -- redeem entire unpaid balance of note before actual sale (equity of redemption)
  -- grant deed in lieu of foreclosure

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Visual No. 8

Division Of Sale Proceeds

- Proceeds are divided in following manner and order:

-- advertising expenses and making conveyance including commission to trustee and attorney

-- full amount of unpaid principal, interest, attorney's fees and other charges as provided by real estate note

-- remaining balance to mortgagor (borrower)

Deficiency Judgments

- Debtor personally liable for debts, expenses
- Purchaser who ASSUMES note is also personally liable for unretired debts
- Purchaser who takes "Subject To" the note avoids personal liability

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Visual No. 10

Invalid Sale

- Sale with an irregularity
- Low foreclosure sales price not sufficient by itself to render invalid
- Inadequacy of consideration may be grounds to have sale set aside

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Visual No. 11

Remedies For Invalid Sale

- Set aside (rescind) sale
- Sue for damages
- Election to pursue one remedy bars action on another
- All must be pursued within four years

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Visual No. 12

Procedural Points In Evaluating The Foreclosure

- Did circumstances actually occur?
  - Did foreclosure occur within four years of default?
  - Did lender notify debtor of intent to accelerate note after default?
- If notices effectively waived, has lender received late payments in past without foreclosure?
- Did trustee post and file notices with county clerk and send notices to debtors at least 21 days in advance of actual sale?

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Visual No. 13

Procedural Points Continued

- If land in more than one county, was notice posted and filed in each county?
- Were personal notices sent to each person liable on note by registered mail to their last known address?
- Was substitute trustee, if any, properly appointed by rightful parties in accordance with terms of deed of trust?
- Did trustee conduct sale in accordance with deed of trust and state law?
- Did expenses and charges levied against debtor's interest following sale constitute usury?

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Visual No. 14

Procedural Points Continued

- Was property in receivorship at time of sale?
- Was debtor alive at time of foreclosure?
- Was debtor minor?
- Was debtor in armed services or discharged within three months of proposed sale?

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